IAASB May 11-13, 2003

Audit Materiality

Agenda Item 4-B
Reasons for Revision

• Some standard setters have updated national standards
• Link with aggressive earnings management
Link with Aggressive Earnings Management

- Inappropriate accounting policies
- Bias in accounting estimates
- Deliberate “immaterial” errors
General Approach

- Existing ISA 320 conceptually sound and provides useful platform for additional guidance
- More judgmental/Less formulaic
- An holistic approach - nature and size
- Materiality levels for individual components reflecting perceived importance to users
- Better understanding of user needs
An Holistic Approach

- Some existing national standards and guidance distinguish between quantitative and qualitative factors.
- Task Force prefers “Materiality depends on the size and nature of the item judged in the particular circumstances”.
- Appendix to proposed ISA gives examples of factors that impact evaluation (covers qualitative factors addressed by national standards and guidance).
Materiality Levels for Individual Components

- Aim to avoid simplistic formulae and encourage auditors to think more about user needs
- Require “materiality levels [to] be determined taking account of the … importance to users of different items disclosed in the financial statements …”
- Does not require the allocation of materiality as currently undertaken by some firms
- Should we note that, for example, users expect cash items to be more precisely stated than estimates?
Better Understanding of User Needs

• Proposed definition:
  “The auditor should consider information to be material if it is probable that its misstatement … would reasonably change or influence decisions, taken on the basis of the financial statements as a whole, by users who have a reasonable understanding of business and economic activities …”
Linkage with Other ISAs

- Accounting Estimates
- Group Audits
- Auditor’s Report
- Fraud and Error
- Corporate Governance Disclosures
Timetable (as for Accounting Estimates)

- First draft of exposure draft considered by IAASB
- Issue exposure draft
- Final ISA 320

- July 2003
- End 2003
- End 2004
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